LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

301 State House
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FISCAL IMPACT STATEMENT

LS 7413
BILL NUMBER: HB 1790

DATE PREPARED: Feb 2, 2001
BILL AMENDED:

SUBJECT: Public Pension and Retirement Benefits.

FISCAL ANALYST: James Sperlik, Jim Landers
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FUNDS AFFECTED: X **GENERAL**
DEDICATED
FEDERAL

IMPACT: State

Summary of Legislation: (1) The bill decreases from ten to five the number of years of creditable service necessary for normal retirement for members of the Indiana State Teachers' Retirement Fund (TRF) and members of the Public Employees' Retirement Fund (PERF) who retire after June 30, 2001.

(2) The bill also decreases from 20 to 12 the number of calendar quarters used in determining the average annual compensation for the purpose of calculating pension benefits for PERF members who retire after June 30, 2001.
It also decreases from five to three the number of years used in determining the average annual compensation for the purpose of calculating pension benefits for TRF members who retire after June 30, 2001.

(3) It increases from 1.1% to 1.2% the multiplier used in calculating pension benefits for PERF and TRF members who retire after June 30, 2001.

(4) The bill requires the state to offer supplemental Medicare coverage to retired state employees and retired teachers.

(5) The bill also requires the state to pay both the employer's and the employee's share of the health insurance premium for retired state employees who meet certain requirements.

(6) The bill authorizes the deposit of an amount that represents full credit for unused vacation, sick and personal days into a cafeteria plan for a participating retired state employee.

Effective Date: July 1, 2001.

Explanation of State Expenditures: *(1) Decrease from ten to five the number of years of creditable service necessary for normal retirement:* The estimated impact for this part of the proposal can be found in the following two tables. (NOTE: The data contained in the following tables for PERF and TRF are based on the actuarial valuation for July 1, 1999.)

PERF

	State	Local Units	Total
Estimated Increase in Unfunded Accrued Liability	$(3.9 M)	$(4.2 M)	$(8.1 M)
Estimated Increase in Annual Funding	$900,000	$2.5 M	$3.4 M
Increase in Annual Funding as % of Payroll	0.1%	0.1%	0.1%

The funds affected are the State General Fund (55%), or $495,000, and various dedicated funds (45%), or $405,000. The percent split represents the amount each fund contributes to personal services in the State Budget.

TRF

	Closed Plan	Post '96 Plan	Total
Increase in Unfunded Actuarial Accrued Liability (UAAL)	$34 M	$2.8 M	$36.8 M
Increase in Employer Contribution Rate:			
Normal Cost	Trace	Trace	Trace
UAAL (40 year amortization)			
Increase in Payout:			
First Year	$.2 M	$1,651	$.201 M
Second Year	$.2 M	$3,906	$.203 M

The fund affected for the Closed Plan is the State General Fund. The Post '96 Plan is actuarially funded by a level percent of payroll paid by the local school corporations.

(2) Decrease from 20 to 12 the number of calendar quarters used in determining the average annual compensation for the purpose of calculating pension benefits: The estimated impact of this part of the proposal can be found in the following two tables.

PERF

	State	Local Units	Total
Estimated Increase in Unfunded Accrued Liability	$75 M	$91 M	$166 M
Estimated Increase in Annual Funding	$9 M	$12 M	$21 M
Increase in Annual Funding as % of Payroll	0.7%	0.6%	0.7%

The funds affected are the State General Fund (55%), or $4.95 M and various dedicated funds (45%), or

$4.05 M. The percent split represents the amount each fund contributes to personal services in the State Budget.

TRF

	Closed Plan	Post '96 Plan	Total
Increase in Unfunded Actuarial Accrued Liability (UAAL)	$376 M	$23 M	$399 M
Increase in Employer Contribution Rate:			
Normal Cost	0.5%	0.5%	0.5%
UAAL (40 year amortization)	0.5%	0.2%	0.4%
Total	1.0%	0.7%	0.9%
Increase in Payout:			
First Year	$1.5 M	$20,247	$1.5 M
Second Year	$3.1 M	$46,664	$3.1 M

The fund affected for the Closed Plan is the State General Fund. The Post '96 Plan is actuarially funded by a level percent of payroll paid by the local school corporations.

(3) Increase from 1.1% to 1.2% the multiplier used in calculating pension benefits:

PERF

	State	Local Units	Total
Estimated Increase in Unfunded Accrued Liability	$144 M	$173 M	$317 M
Estimated Increase in Annual Funding	$17 M	$23 M	$40 M
Increase in Annual Funding as % of Payroll	1.4%	1.2%	1.3%

The funds affected are the State General Fund (55%), or $9.35 M, and various dedicated funds (45%), or $7.65 M. The percent split represents the amount each fund contributes to personal services in the State Budget.

TRF

	Closed Plan	Post '96 Plan	Total
Increase in Unfunded Actuarial Accrued Liability (UAAL)	$537.7 M	$33.2M	$570.9 M
Increase in Employer Contribution Rate:			
Normal Cost	0.7%	0.7%	0.7%
UAAL (40 year amortization)	0.7%	0.2%	0.6%
Total	1.4%	0.9%	1.3%
Increase in Payout:			
First Year:	$2.2 M	$28,294	$2.2 M
Second Year:	$4.6 M	$65,209	$4.6 M

The fund affected for the Closed Plan is the State General Fund. The Post '96 Plan is actuarially funded by a level percent of payroll paid by the local school corporations.

(4) This provision requires the state to offer supplemental Medicare coverage to retired state employees and retired teachers. The annual cost of this provision could potentially range from an estimated $94.3 M to $156.3 M depending upon the employer premium and the type of coverage that is offered.

The provision requires the state to pay an amount it establishes in connection with the purchase and maintenance of the Medicare supplement insurance coverage as part of the state retirees insurance program. (Note: Provision (5) of the bill requires the state to pay both the employee and employer premiums for insurance coverage for retirees not yet eligible for Medicare.) The two estimates below are based on the state paying the employer premium (6.5% of the total premium cost) for Medicare supplement insurance, and paying the entire premium cost for this insurance coverage.

The annual premium cost for Medicare supplement insurance is estimated to be $2,789 for single coverage and $5,880 for family coverage. Currently there are about 9,901 retired state employees and about 24,411 retired teachers who are 65 years of age or older. Survey research by the U.S. Census Bureau suggests that approximately 54.7% of these retirees are married with their spouse present. On this basis, approximately 15,543 retirees would obtain single coverage and 18,769 retirees would obtain family coverage. Under the two scenarios outlined above, the retiree would either make no payment for the coverage or would pay 6.5% of the annual premium cost - $191 for single coverage or $382 for family coverage. Given these premium amounts, it is assumed that all of the retirees would elect to obtain the state-provided Medicare supplement insurance. If the state were to pay the entire premium cost for Medicare supplement insurance, the annual cost to the state would total an estimated $156.3 M. If the state were to pay an employer premium equal to 93.5% of the annual premium, the annual cost to the state would total an estimated $146.2 M. Even if only single coverage were offered by the state, the annual cost could potentially range from $94.3 M to $100.8 M, depending upon the employer premium. The funds affected are the State General Fund and various dedicated funds.

(5) This provision requires the state to pay the entire premium cost (employee and employer premium) for health insurance coverage of retired state employees who are not eligible for Medicare. This provision is estimated to result in a net cost to the state ranging from approximately $1.4 M to $7.3 M annually. The net fiscal impact of this proposal is based on the difference between the increase in health care costs to the state due to the additional retiree health benefits and the reduction in compensation costs to the state from those

individuals hired to replace the retirees. These financial trade-offs are described below for five groups of state retirees. The fiscal impact for each group is summarized in the table below.

Employee Group	**Estimated Net Increase (Reduction) in Cost - Low Estimate**	**Estimated Net Increase (Reduction) in Cost - High Estimate**
Group A	$1.2 M	$1.2 M
Group B	$4.2 M	$10.1 M
Group C	($4.0 M)	($4.0 M)
Group D	minimal	minimal
Group E	minimal	minimal
Total	$1.4 M	$7.3 M

Group A : This group consists of retired state employees who are currently on the state health plan. The cost to the state for Group A is the most straight forward of the several employee groups to estimate. There are about 331 retired state employees in this group, about 84% of whom are on single coverage and 16% are on family coverage. The additional cost to the state as a result of this proposal is the total premium that is currently being paid by the retiree but would now be paid by the state. The weighted average of this cost is estimated to be about $3,540 per year per employee resulting in an additional total cost for this group of about $1.2 M.

Group B: This group consists of retired state employees who are not currently on the state health plan, but would have an increased incentive to participate in the state health plan under the provisions of the bill. There are about 11,432 retired state employees. Of these, about 9,901 are over 65 years of age. This results in an estimated 1,531 retirees under the age of 65. Of the 1,531 retirees, about 331 (Group A) are currently on the state health plan. This leaves 1,200 retirees who are currently not on the state health plan but will now see the price for such health insurance coverage decline from 100% of the annual premium to no premium payment at all under this provision. This represents a significant price decrease and would provide a substantial incentive for the retiree to now participate in the state health plan.

The cost to the state for each of these individuals, however, is not necessarily merely the average premium. This group, since they are newly covered and being older than the average state employee, may cost more to provide health benefits to than the average employee. The state would be responsible for the total claims costs for this group. However, since this group is not currently on the health plan, the claims costs of this group are not known. An upper limit can be estimated based on the claims expenditures of Group A, described above. Group A has an adverse experience factor in that Group A has about $2.37 in claims expenditure for every dollar of claims expenditure experienced by the state employee group as a whole. Consequently, the 1,200 individuals that might now choose to participate in the health plans may cost the state $10.1 M.

However, this probably overestimates the cost of this group. The retired employees that currently choose to pay both the employee and the employer share of the premium to participate in the state health plan (Group A) is probably a high cost group. Group A represents about 22% of the state employee early retirees -- the

Congressional Budget Office estimates that 25% of the population accounts for about 90% of health spending. Consequently, using the claims experience of Group A probably significantly overestimates the probable costs of the other 78% of the early retiree population that has previously chosen not to purchase state health insurance. Assuming an estimated claims expenditure equivalent to the state employee population as a whole and assuming only a 90% participation rate (since all employees may not choose to participate even at the lower price) results in an estimated net cost to the state of about $4.2 M. This represents a lower bound.

Thus, the cost to the state of Group B is expected to fall somewhere between $4.2 M and $10.1 M.

Group C: This group consists of active state employees who are currently on the state health plan and who retire early and are replaced by newly hired employees. These active state employees are eligible for early retirement and, because of the provisions of the bill, perceive the cost of retirement to have decreased enough to retire while remaining on the health plan. The cost estimate, however, must include the cost related to the new employees hired as replacements as well as the cost related to the retiring employees.

Based on an experience study by the actuaries for the Public Employees' Retirement Fund (PERF), about 10% of those individuals eligible for retirement each year actually retire. With the reduced costs of health insurance offered in this proposal, the actuaries estimated that about 18% of those individuals eligible would retire early. This is estimated to represent about 676 new retirees resulting in about $2.4 M in additional costs for health care. (These costs may be overstated to the extent that replacement employees would likely be younger and have lower claims expenditures than the average employee.) The health costs borne by the state would not change for the retiree.

Lower salary and salary-related expenditures could potentially offset the higher health benefit costs borne by the state because a new replacement employee would likely receive a lower salary, and would incur lower salary-related expenditures, as well. An average reduction in annual salary is estimated to be $8,000 with 19.56% in salary-related fringe benefits (i.e., life insurance, social security, PERF contributions, and disability insurance) and would result in a cost reduction of about $6.4 M. The resulting net reduction in health and salary costs for this group is estimated to be about $4.0 M (i.e., $6.4 M less $2.4 M).

There could also be some impact on pension costs resulting from a lower pension contribution for the new employee and earlier payout of pension benefits for the retiree. However, this has not been estimated at this time.

Group D: This group consists of active state employees who are currently on the state health plan and who retire early but are not replaced by newly hired employees. These active state employees are eligible for early retirement and, because of the provisions of the bill, perceive the cost of retirement to have decreased enough to retire while remaining on the health plan.

Although it is possible that retiring employees are not replaced, for the purposes of this analysis, it is assumed that all employees are replaced. However, to the extent that a retiree is not replaced, there would be no change in health care costs borne by the state. In addition, there would be a reduction in salary and salary-related fringe benefits associated with the retiring employee. Upon an employee's retirement, the state's pension contributions would stop. However, pension benefit payments would begin earlier than they would if the employee did not retire. The impact of this group is assumed to be minimal.

Group E: This group consists of active state employees who are not currently on the state health plan and who are eligible for early retirement.

This group of active employees does not currently purchase coverage under the state employee health plans, even under the provision that the active employee contribute only about 6.5% of the insurance premium. Consequently, it is assumed that reducing the cost of insurance for retirees would not provide sufficient incentive to result in major shifts of such employees into retirement status. The impact of this group is also assumed to be minimal.

The funds affected are the State General Fund and various dedicated funds.

(6) *Deposit of an amount that represents full credit for unused vacation, sick, and personal days into a cafeteria plan for a participating retired state employee:*

Currently, the state pays for up to 30 unused vacation days upon retirement. In addition, retiring state employees with more than 10 years of service are allowed partial credit for the remaining unused vacation, sick, and personal days up to a maximum of $5,000. The credit is deposited on behalf of the retiree into a cafeteria plan. For those individuals who retired in 2000, the value of the unused vacation, sick, and personal days, over and above the current statutory restrictions, is $2.1 M. This additional state expenditure is assumed to occur annually and is effective for FY 2002. The number of retirees categorized by the amount of additional deposits into the cafeteria plan are provided in the following table.

Amount of Gain to Retirees from Provision	**Number of Retirees**
$0	417
More than $0, But less than $100	113
More than $100, But less than $500	155
More than $500, But less than $1,000	57
More than $1,000, But less than $10,000	205
More than $10,000, But less than $100,000	54
Total Retirees > 10 Years of Service	1,001

Explanation of State Revenues:

Explanation of Local Expenditures:

Explanation of Local Revenues:

State Agencies Affected: PERF; TRF; All.

Local Agencies Affected:

Information Sources: Keith Beesley, State Department of Personnel, 232-3062; Doug Todd of McCready & Keene, Inc., actuaries for the Public Employees' Retirement Fund, 576-1508; Denise Jones of Gabriel

Roeder Smith & Co., actuaries for the TRF, 1-800-521-0498; U. S. Census Bureau, 65+ in the United States, P23-190 Current Population Reports: Special Studies, April 1996; Medicare Supplement rates from the Teachers Retirement Fund program.

DEFINITIONS:

Amortization paying off an interest bearing liability by gradual reduction through a series of installment payments as opposed to paying it off by one lump sum payment.

Funding a systematic program under which assets are set aside in amounts and at times approximately coincident with the accruing of benefit rights under a retirement system.

Unfunded Actuarial Liability (sometimes called the unfunded liability) of a retirement system at any time is the excess of its actuarial liability as that time over the value of its cash and investments.